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86-2.2- Interest for all residential health care facilities. (a) Necessary interest on both current and capital indebtedness is an allowable cost for all residential health care facilities.

(b) To be considered as an allowable cost, debt generating interest shall be incurred to satisfy a financial need, and interest expense shall be at a rate not in excess of what a prudent borrower would have had to pay in the money market at the time the loan was made. Also, the interest shall be paid to a lender not related through control, ownership, affiliation or personal relationship to the borrower, except in instances where the prior approval of the Commissioner of Health has been obtained.

(c)(1) Interest expense shall be reduced by investment income with the exception of income from funded depreciation, qualified pension funds, or in instances where income from gifts or grants is restricted by donors. Interest on funds borrowed from a donor-restricted fund or funded depreciation is an allowable expense.

(2) Investment income reported for the fiscal year ending December 31, 1983, (or for a subsequent fiscal year if that subsequent year's report is being used by the department to establish the basic rate pursuant to section 86-2.10 of this Subpart) shall reduce the interest expense allowed for reimbursement as follows:

(i) For all residential health care facilities, investment income shall first reduce the interest expense allowed each year for operational cost reimbursement; and

(ii) the amount of any remaining investment income, after application of (i), shall reduce the interest expense reimbursed each year as capital cost for voluntary and public facilities; and

(iii) the amount of any remaining investment income, after application of (ii), shall not be considered in the computation of the rate.

(d) interest on current indebtedness shall be treated and reported as an operating, administrative expense.

(e) interest on capital indebtedness, as defined in paragraph 86-2.21(a)(1) of this Subpart, except as provided for in section 86-2.2(c) of this Subpart for rate years beginning January 1, 1986 and thereafter, is an allowable cost if the debt generating the interest is approved by the Commissioner, incurred for authorized purposes, and the principal of the debt does not exceed either the approval of the Commissioner or the cost of the

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(1) For all residential health care facilities, investment income shall first reduce the interest expense allowed each year for operational cost reimbursement; and

(ii) the amount of any remaining investment income, after application of subparagraph (i), shall reduce the interest expense reimbursed each year as capital cost for residential health care facilities; and

(iii) the amount of any remaining investment income after application of subparagraph (ii), shall not be considered in the computation of the rate.

(3) For rate years beginning on or after January 1, 1994 for all residential health care facilities investment income reported for the same year used to compute capital cost reimbursement for a facility's rate shall reduce the interest expense allowed for reimbursement [as provided in subparagraph (c) (2) (i)-(iii) of this section.]

(d) (1) Interest on current indebtedness shall be treated and reported as an operating, administrative expense for rate years beginning prior to January 1, 1994. For rate years beginning on or after January 1, 1994, interest on current indebtedness, reported for the same cost report period used to compute capital cost reimbursement for a facility's rate, shall be reported as an administrative expense and reimburse as a nontrendable expense.

(2) (a) Approval by the commissioner shall be required for reimbursement of interest expense on current indebtedness incurred on or after January 1, 1994 when such interest expense exceeds the threshold established for that calendar year. The threshold for each calendar year shall be equal to the prime lending rate as published in the first issue of the Wall Street Journal for the calendar year plus 200 basis points (200 points equals 2%) on a loan principal of \$270,000 for facilities with 120 or less beds or \$270,000 plus an additional \$2,250 for each bed over 120 for facilities with more than 120 beds. Approval shall be granted in accordance with the standards set forth in subdivision (b) of this section. Prior approval shall not be required.

*For example, for a home with 100 beds (i.e., less than 120) the threshold would be prime rate + 2% applied to \$270,000. For a home having 150 beds, the threshold will be prime rate + 2% applied to \$270,000 + \$2,250 (30 beds) or \$337,500.

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(b) New facilities without adequate cost experience whose rates are calculated pursuant to section 86-2.15 of this Subpart shall be exempt from the requirements in subparagraph (a) until January 1st of the first calendar year used as the basis for computing capital cost reimbursement and for which a cost report is filed subsequent to the cost report described in section 86-2.2(e) of this Subpart. This exemption shall not apply to operating facilities that open new discrete units providing services reimbursed in accordance with the provisions of paragraphs (5), (6) and/or (7) of section 86-2.15(b) of this Subpart or other similar discrete units providing care to residents with special needs that receive a separate and distinct payment rate under section 86-2.15 of this Subpart.

(c) The interest expense threshold for facilities operated by receivers or new operators who are required to file a cost report for the first twelve-month period of operation pursuant to section 86-2.10(k) of this Subpart shall be established for that cost report period in accordance with subparagraph (a) of this paragraph, using the prime lending rate in effect on January 1st of the year in which the cost report period begins.

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(e) Interest on capital indebtedness, as defined in paragraph 86-2.21(a)(1) of this Subpart, except as provided for in section 86-2.20(c) of this Subpart for rate years beginning January 1, 1986 and thereafter, is an allowable cost if the debt generating the interest is approved by the commissioner, incurred for authorized purposes, and the principal of the debt does not exceed either the approval of the commissioner or the cost of the authorized purposes. Interest related to refinancing indebtedness shall be considered an allowable cost only to the extent that it is payable with respect to an amount equal to the unpaid principal of the indebtedness than being refinanced. However, interest incurred on refinanced debt in excess of the previously unpaid balance of the refinanced indebtedness will be allowable on acceptable demonstration of the commissioner of health that such refinancing will result in a debt service savings over the life of the indebtedness.

(f) Where a public finance authority has established a mortgage rate of interest such that sufficient cash flows exist to retire the mortgage prior to the stated maturity, the amount of the mortgage to be forgiven, at the time of such forgiveness, shall be capitalized as a deferred asset and amortized over the remaining mortgage life, as a reduction to the facility's capital expense.

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86.2.21 Capital Cost reimbursement for proprietary residential health care facilities. (a) *Definitions*. As used in this section, the following terms shall be defined as follows:

(1) *Capital indebtedness*. The term *capital indebtedness* shall mean all debt obligations of a facility that are:

(i) evidenced by a mortgage note or bond and secured by a mortgage on the land, building or nonmovable equipment of a facility or evidenced by a note incurred in accordance with subparagraph (ii) of this paragraph;

(ii) incurred for the purpose of financing the acquisition, construction or renovation of land, building or nonmovable equipment (hereinafter called the "authorized purpose"); and

(iii) found by the commissioner to be reasonable, necessary and in the public interest with respect to the facility in accordance with standards set forth in section 86-2.21(e)(3)(ii) of this Subpart. Refinancing of capital indebtedness shall be recognized only to the extent of the then unpaid balance of the debt being refinanced.

(2) *Commissioner*. The term *commissioner* shall mean the Commissioner of Health of the State of New York.

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(3) *Department*. The term *department* shall mean the Department of Health of the State of New York.

(4) *Equity*. The term *equity* shall mean all cash or other assets, net of liabilities, invested by a facility or its operator in land, building and nonmovable equipment, and found by the commissioner to be reasonable, necessary and in the public interest with respect to the facility. *Equity* shall not include any change in the book value of a facility resulting from reevaluation of assets or from the amortization of capital indebtedness resulting from payments made pursuant to subdivision (e), paragraph (3) of this section.

(5) *Facility*. The term *facility* shall mean a proprietary residential health care facility, as the term *residential health care facility* is defined in article 28 of the Public Health Law and in regulations of the department.

(6) *Initial allowed facility cost*. The term *initial allowed facility cost* shall mean the portion of certified costs approved by the commissioner or, in the case of facilities granted operating certificates prior to April 15, 1973, the costs of the facility as verified by audit to the satisfaction of the commissioner or, in the case of facilities not able to comply with either of the foregoing standards, costs imputed

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pursuant to subdivision (g) of this section, in or prior to the first year of useful facility life attributable to the acquisition of land and the construction, acquisition or renovation of building and nonmovable equipment. The commissioner shall disregard any costs relating to prior transactions involving the facility which he finds were not bona fide or the terms of which are found to be other than fair and reasonable.

(7) Useful facility life. The term useful facility life shall mean a period of 40 years measured from the calendar year in which a facility commences operations as determined by the commissioner.

(8) Rate of return. The term rate of return shall mean the annual rate of return on equity invested, [as said rate is determined by the United States Department of Health, Education and Welfare as an element of reasonable cost for purposes of payments to or reimbursement of proprietary providers under title XVIII of the Federal Social Security Act.] and said rate for a rate year shall be equal to the yield on thirty year United States Treasury bonds in effect on the second Wednesday of September of the year prior to the rate year.

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(9) Capital improvement. The term capital improvement shall mean any addition to, replacement of, or improvement of a capital item of plant or nonmovable equipment approved by the commissioner as reasonable, necessary and in the public interest.

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(10) *Capital improvement cost.* The term *capital improvement cost* shall mean the actual expenditure or portion thereof attributable to a capital improvement approved by the commissioner as reasonable, necessary and in the public interest.

(11) *Hospital-based residential health care facility.*
The term *hospital-based residential health care facility* shall mean a facility holding a certificate of operation as a residential health care facility which is wholly owned by a hospital as that term is defined in Subpart 86-1 of this Title, and is physically located in a building or buildings, part of which building or buildings are also used for provision of acute care hospital services.

(12) *Effective term.* The term *effective term* shall mean the number of years and months required, pursuant to the term of the note or mortgage, to fully amortize the principal of debt, predicated upon the regular principal payments required by the mortgage or note, but determined without regard to any provision for making the balance all due and payable at a given date or upon a stated event, and without regard to any provision for acceleration of the debt or any original or subsequent agreement for the suspension or moratorium of principal payments.

(b) Subject to subdivision (f) of this section, the reimbursement rate of every facility certified by the commissioner

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and approved by the State Director of the Budget pursuant to article 28 of the Public Health Law shall, in each year of useful facility life, include a capital cost component determined in accordance with the provisions of subdivision (c), (d) or (e) of this section applicable to the facility in such year.

(c)(1) The provisions of subdivision (e) of this section shall not apply for the term prescribed by paragraph (3) of this subdivision to any facility which, as of the effective date of this section, is located in and operated from leased space pursuant to a lease:

(i) which was entered into and approved for reimbursement prior to March 10, 1975; and

(ii) which the commissioner finds to be bona fide, valid and noncancelable; and

(iii) the payments, or a portion thereof, made pursuant to such lease are found by the commissioner to have been the proper basis for reimbursement of capital cost paid to such facility pursuant to article 28 of the Public Health Law prior to March 10, 1975.

(2) The capital cost component of a facility within the provisions of paragraph (1) of this subdivision shall, for the term prescribed by paragraph (3) of this subdivision, consist of

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a payment factor sufficient to reimburse the facility for the total payments required under its lease to the extent approved by the commissioner pursuant to paragraph (1) of this subdivision, and subject to the historical limitations set by the commissioner.

(3) Capital cost reimbursement for leased facilities shall be made pursuant to this subdivision for the balance of the lease term (computed without regard to any future extension or option to renew authorized by the lease) remaining as of the effective date of this subdivision. Upon the expiration of such balance of the lease term provided in an approved lease (as said lease so provides as of August 1, 1977) or such earlier expiration date as may be agreed to by the parties to an approved lease, capital cost reimbursement shall be made pursuant to subdivision (e) of this section notwithstanding any extension or renewal of such lease or the execution of a new lease by or on behalf of the facility, provided, however, that the commissioner may, in his discretion, continue capital cost reimbursement for such leased facilities pursuant to this subdivision, at a rental amount approved by the commissioner prior to such extension or renewal, and not pursuant to subdivision (e), upon his finding that there is a public need

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